

Problems at State Electric Company Darken Honduran Energy and Fiscal Outlook

A November 2007 report from U.S. Embassy, Tegucigalpa

Summary: *Honduras faces a looming crisis in its electricity sector due to inadequate generating capacity, over-reliance on high-cost bunker fuel, management instability, technical and administrative losses and a reluctance to raise rates to levels sufficient to cover costs. The state-owned electric company, ENEE, is losing an estimated US\$200 million a year. At that rate, the debt created by ENEE could approach the total borrowing capacity of Honduras within five years. Losses will probably increase if reforms are not undertaken.*

A Looming Power Crunch?

ENEE, which has a monopoly on electricity transmission and distribution in Honduras, estimates Honduras needs to add 250 megawatts of capacity by 2009 to meet growing power demand. The World Bank puts the figure much higher – up to 380 megawatts by 2010 if efficiency measures are not taken. This adds up to a whopping 20-30 percent increase in installed capacity within three years. Brownouts or blackouts could hit in 2008 or 2009 if new capacity is not added quickly. Some industries, in particular textile plants in export processing zones, are building their own power plants to guard against supply disruptions.

In August 2007 the Honduran Government announced plans to directly purchase 250 megawatts of new capacity, with contracts to be awarded in November. Potential suppliers were initially requested to sell power in the range of 10 cents a kilowatt-hour. Numerous existing power plant owners have stated they cannot supply power at that price. They say their costs, primarily for the heavy fuel oil (bunker) that accounts for about 70 percent of the country's current power generation (the rest is hydroelectric), have doubled in the past decade. Therefore, it is unlikely that the next generation of power plants will use bunker fuel. Coal is an option, and should be profitable in the 14 c/kwhr range. It is not clear if the current thermal producers will bid at this price. Most say coal would be profitable at 14c/kwhr, though this could increase as worldwide coal prices rise.

Losing Money on Every Kwh Delivered

According to the World Bank, ENEE pays an average of 14 U.S. cents a kilowatt hour to current power generators. About one-quarter of the power it purchases does not reach paying customers – it is either lost in transmission, stolen or unrecovered due to billing errors. It sells the remaining 75 percent for an average price of 11 cents a kilowatt hour. Residential rates are just 8 cents a kilowatt-hour, compared with a Central American average of 14 cents. Within Central America, only Costa Rica, with its well-developed and low-cost hydroelectric plants, charges less (7 cents) to residential

customers than Honduras. With this negative cash flow on each unit of electricity produced, ENEE is accumulating arrears to private power producers, and the Honduran Government is struggling to cover its mounting debts.

Honduras is well endowed with water resources that could be developed for hydroelectric power. But long delays in issuing environmental permits has impeded such projects. The few hydro projects that have been approved have taken an average of four years, which is too long to be able to satisfy the country's immediate power needs. A bill that would create a more favorable environment for hydro and other renewable energy projects was passed by the National Congress in October.

ENEE's debt would be much greater if not for recent international debt forgiveness negotiated by the Honduran Government. Over the last few years, international creditors have forgiven nearly US\$4 billion of Honduran official debts. This wiped nearly US\$1 billion off ENEE's debit sheet. Technically, ENEE's forgiven debt is owed to the Government of Honduras, which in turn is obligated to devote the funds it would have used for principal and interest payments on the written-off debt to poverty reduction programs. However, the estimated US\$200 million in new liabilities the Honduran Government will incur this year as a result of ENEE's negative cash flow will roughly equal what it would have spent to service the written-off debt. In effect, then, the financial resources made available through international debt forgiveness are being used entirely to subsidize electricity consumption.

Management in Disarray

ENEE has had five managers in the last 18 months. In June 2007 President Zelaya put the company under military control, originally for 90 days. The military, which readily admits to having no expertise at running an electrical utility, is now expected to relinquish control of ENEE in December 2007. What will happen with the company next is yet to be determined.

Whoever assumes managerial control of ENEE will confront an array of difficult challenges. Of the power ENEE purchases from generators, 10 percent is physically lost through transmission – so-called *technical losses*. A further 15 percent is not paid for as a result of either illegal connections (30 percent), billing fraud (40 percent) or billing errors (30 percent) – collectively referred to as *commercial losses*. Thus, 25 percent of the power ENEE transmits is not paid for. This compares with a Central American average of 15 percent.

Technical losses could be reduced through better maintenance or purchasing more efficient equipment. Reducing commercial losses, however, requires improved management and a stronger legal environment. Illegal connections are the most difficult source of loss to address, because Honduran police and courts have shown themselves to be either unwilling or unable to stop pirates from stealing electricity. A bill currently before the Congress would explicitly list electricity theft as a crime. But it is not certain

whether or when it will become law, and police and courts would still have to demonstrate the will to enforce it.

Fiscal Impact

Even if technical and commercial losses and managerial inefficiencies were reduced to their realistic minima, experts assess that at best ENEE's operating losses would be reduced only by half. To restore the company to positive cash flow, electricity rates will have to be increased. However, at his 2005 inauguration, President Zelaya promised not to raise rates during his presidency. As a result, the World Bank forecasts ENEE's losses could soon reach US\$239-400 million a year, equivalent to 2-4 percent of Honduran GDP.

More recently, some in Zelaya's administration have hinted publicly that a rate increase may be in the offing in 2008. Meanwhile, the Government plans to issue bonds to cover operating losses and pay back arrears to thermal plant operators, reported to equal US\$78 million. Congress will have to approve such a bond issuance, probably in 2008. Meanwhile, in early November 2007 the Government announced it would borrow from public employee pension funds and from commercial banks to pay ENEE's debt to the thermal plants.

In October 2007 the Honduran Government announced plans to issue US\$200 million worth of medium-term bonds to allow ENEE to restructure its debts. Leftover proceeds would go toward maintaining or procuring new equipment, such as meters and transformers, to reduce technical losses. The government is also trying to renegotiate contracts it signed with two thermal producers during an energy crisis 14 years ago, one of which is a diesel plant that is not currently operating because of its high cost.

Comment

Real reform capable of returning ENEE to profitability and meeting Honduras's energy needs at reasonable cost will require a number of years. Such reform should include support for renewable energy; reduction of technical and commercial losses; improved management and reducing demand through conservation. However, no reform plan is likely to succeed unless customers are made to pay for their electricity what it actually costs to provide it. This can be done in such a way as not to harm Honduras's many poor households, for example by targeting electricity subsidies, which currently benefit many relatively well-off Hondurans, to the truly needy. Capital from international financial institutions and bilateral donors, as well as private investment, could be forthcoming to help address Honduras's energy needs if the proper policy environment is put in place.